United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

74-1982

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

In the Matter -of- MAY LEE INDUSTRIES, INC., Appellant. (In Proceedings for An Arrangement No. 74-B-166)	Docket No. 74-1982

REPLY BRIEF FOR APPELLANT, TRUSTEE ON APPEAL FROM ORDER OF DISTRICT COURT

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STATEMENT OF THE CASE

This Brief is the Appellant's Reply Brief to the Briefs of Appellees Chemical Bank and Chartered Bank of August 6, 1974. The original Brief of the Appellant was submitted on July 30, 1974. Pursuant to the orders of this Court of July 23, 1974 and July 29, 1974, the Appellant was permitted to file this Reply Brief and serve it upon the Appellees on or before 4:00 p.m., August 8, 1974. The Argument for Appeal has been set, pursuant to said orders, for Monday, August 12, 1974. The orders permitted the parties to proceed by typewritten briefs and appendices.

I. DESCRIPTION OF THE COLLATERAL IN THE SECURITY AGREEMENT OF CHARTERED BANK WAS NOT VALID.

On pages 16-19 of the Brief of the Appellee Chartered Bank, said Appellee argues that the description of the collateral in its so called security agreement is legally sufficient.

A. Appellees Change Argument

The Appellee, Chartered Bank, is now changing its argument. Where its original case was based solidly on the fact that there was no need to identify the collateral since Apellee Chartered Bank and Appellee Chemical Bank together owned all the inventory, they now argue that they have in fact adequately described the inventory. (See page 11 of Appellant's original Brief of July 30, 1974 where the attorney for Chartered Bank describes his theory of this case quoted from pages 11-13 of the hearing of April 9, 1974).

Appellee Chemical Bank supports Chartered Bank in its argument on pages 31-33 of its Brief but states on page 33 that if the holding of the Court below was clearly erroneous, it would then be incumbent on the Court to grant Appellee Chemical Bank a lien on all the goods which the Chartered Bank lien does not cover.

The gist of the argument of Appellee Chartered Bank is that the U.C.C. modified the strict requirements of the law which heretofore had not only required a full and adequate description but also that the serial number of the collateral be precisely correct. Indeed the Appellant conceeds

that the "serial number" test no longer applies.

Nevertheless the Appellee Chartered Bank has not begun to meet any test of description. In fact it has basically refused to identify or describe goods to which its alleged lien applies because the documents and information available make such identification clearly impossible. On page 47 of Appellants Brief of July 30, 1974 the description of collateral on all of the trust receipts submitted by Chartered Bank as part of its petition is quoted. This description is clearly inadequate to meet any test or do any job.

B. Cases Cited By Appellees Re Description of Collateral

The cases cited by Appellee Chartered Bank in its Brief actually support the Appellant. The Appellee cites two cases on pages 17 and 18. The first case is Rusch Factors Inc. v. Passport Fashion Ltd. 322 NYS 2d 765, affd. 327, N.Y.S. 2d 536. This case, a 1971 decision of the Supreme Court of New York County would seem to be relevant.

In that case where the Court construes the UCC in its broadest possible terms, the Security Agreement made reference to documents listed on its back that represented and presumably described the goods. In fact those documents were not attached to the security agreement. Therefore the Court's holding was that the Security Agreement did not adequately describe the collateral and was invalid. As the Court states 322 N.Y.S. 2d 765, at 768:

In the case before me, there was attempted compliance with Article 9 of the Uniform Commercial Code (Secured Transactions), but for some unexplained reason, the documents, incorporated by reference in the Security Agreement, which would have described the property to be covered, were not attached.

There were not documents which never existed, but documents which did exist, but through some inadvertence, were never attached to or listed in the main instrument.

While the content of these documents has now been shown by stipulation, I am satisfied that by reason of their absence from the Security Agreement, a reasonable inquirer, upon reviewing the Security Agreement, with or without the Financing Statement, would not have had revealed sufficient information to provide an adequate description of the collateral. Reading the Financing Statement or the Security Agreement, alone or together, does not provide sufficient information from which a searcher could determine what funds in the hands of the factors were earmarked to preserve a preferred creditor position for Itoh.

The Security Agreement is therefore not enforceable, as creating a secured transaction, insofar as third parties are concerned.

Similarly in this case the uncontradicted testimony is that the Security Agreements never had attachments to them despite the fact that some of them and only some of them made reference to attached documents. (See pages 9-11 of Appellants Brief of July 30, 1974 quoting from hearing of April 19 pages 62, 63 and hearing of April 9, pages 55-56).

The Appellees Chartered Bank and Chemical Bank makes reference to only one other case in support of their position, namely In Re Nickerson & Nickerson Inc 452 F 2d 56 (8th Circ. 1971). That case is not in point. The Appellant in that case "...contends that the language of the Security Agreement is inadequate to describe Nickerson's merchan-

dise inventory other than the merchandise located in its Missouri stores." (at p. 57). The further issue is whether it covers goods on hand at the time of signing or other goods in the stores outside Missouri.

The Court held the parties created a lien in all the stores by attachment of a financing statement that referred to stores in each particular state. (at p 57). There were attached schedules that described the collateral (at p 56). The question merely was whether the words were sufficiently broad to include collateral in other stores. The quote of the Appellee Chartered Bank on page 18 of its Brief is taken out of context. The question of the adequacy of description of collateral was never raised in the court, merely the question of whether the description included collateral in other states.

C. Requirements of Law Re Description of Collateral

4A Collier on Bankruptcy, 14 ed pg 354-356 states the following:

> In other words, to sustain a claim to trust property or to an equitable lien thereon, the claimant must depend upon his ability to identify the property in its original or substituted form in the hands of the bankruptcy trustee. The basic idea of the trust doctrine as applied in bankruptcy is a fair and reasonable identification of the property or fund so as not to harm other creditors. It is not enough, therefore, to show merely that the funds or property came into the bankrupt's hands or went into the bankrupt's business or, by the better view, even that the funds or property are contained somewhere within the bankrupt's estate. If the trust fund or property cannot be identified in its original or substituted form, the cestui becomes merely a general creditor of the estate, for the prevailing rule in trusts is that "a beneficiary who cannot find the trust property has no lien or charge spread over the entire estate of the faithless trustee."

Furthermore, Collier on p. 358 describes who has the burden of proof in this matter:

> As indicated previously, the claimant must assume the burden of ascertaining and tracing the trust property, and where it is alleged that such property has been converted into other property in the hands of the bankrupt, the claimant has the burden of tracing the trust property therein. If the claimant succeeds in making the requisite proof, it then devolves upon the bankruptcy trustee to distinguish between what belongs to the estate and what belongs to the cestui que trust.

4A Collier also states:

> A reclamation proceeding is directed against the property in possession of another (either a trustee or receiver in bankruptcy where one has been appointed), and to regain such property the claimant must affirmatively establish his own right to possession by proving ownership, absolute or qualified. Thus the general burden of proof is on the claimant, and where he fails to sustain this burden his petition will be denied. (pp. 476-477)

> A petitioner in reclamation is required to identify positively the property he seeks to reclaim. Where property sought has been mingled with other goods or property of the bankrupt, the claimant must trace his property according to the principles previously set forth in this treatise. If he fails he cannot reclaim, no matter what the equities are, and he is relegated to the position of asserting his rights as a general creditor. (p. 478)

The Appellees have hardly sustained this burden of proof. In fact their basic argument is that they do not have to sustain the burden of proof.

D. Chemical Bank's Interest in the Inventory Collateral is Nil

Appellee Chemical Bank completely ignores the fact that legally as between Chemical Bank and the Appellant-trustee it cannot succeed if

the Chartered Bank lien fails. In addition it ignores the fact that it had knowledge of the Chartered Bank alleged lien and as between it and the Appellant-trustee, it could under no circumstances persevere. The knowledge of Appellee Chemical Bank of Appellee Chartered Bank's alleged lien is set forth in their alleged contract and security agreement, which makes specific reference to the Chartered Bank filing with the Secretary of State in New York. It is well known that even without resort to the Bankruptcy laws, a person with knowledge of a prior lien cannot prevail by recourse to failure to perfect filing, but is bound as if the filing was perfected. (See UCC 1-201(25), (26) and relevant provisions UCC Sec. 9-301(1)(b).

The powers of a trustee under Section 70C of the Bankruptcy Laws are described in 4A Colliers, p. 595, 596, as follows:

> It was said of the precursor of this provision that it conferred upon the trustee 'by force of law' the status of the ideal creditor, irreproachable and without notice, armed cap-a-pic with every right and power which is conferred by the law of the state upon its most favored creditor who has acquired a lien by legal or equitable proceedings. If the description of the trustee's position under former law Sec. 70C was apt, it is more so under the broader language of the amended 70C.

While Collier goes on to modify this statement somewhat, clearly Appellee Chemical Bank could not prevail as against the Appellant-trustee.

E. Appellant is A Trustee and Appellees Cannot Easily Prevail Against Trustee.

Lest there be any question regarding the Appellant's status as

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a trustee the following are references in 8 Collier at the pages specified to the debtor-in-possession status:

> Careful distinction must be drawn between a debtor and a debtor in possession (p 949)
>
> If the debtor continues in possession of his property pursuant to Sec 342, then as debtor in possession he has a separate and additional status with incidents of its own. (p 949)
>
> A debtor who continues in possession is a court officer analogous to a receiver or trustee and he has no greater right to possession than a receiver or trustee has. (p 954)
>
> A debtor who continues in possession is vested by sec 342 with all the titles of a trustee appointed under the Act. That means the title possessed by a trustee appointed under sec 44 in an ordinary bankruptcy proceeding under Chapter I-VII. (p 957)
>
> By virtue of sec 342, the provisions of Sec 70 also determine the property to which a debtor in possession has title as debtor in possession;... (p 957)
>
> Both Chapter X and Chapter XI thus give a debtor in possession the powers which a trustee in the proceeding would have. (p 960)
>
> But it has been held under former Sec 77B, which is similar to Sec 342 in that it referred to the powers but not the rights of a trustee, that an attempted distinction between the powers of a debtor in possession and rights of a trustee in bankruptcy is unreal. Hence it would appear that the difference between Sec 342 of Chapter XI and Sec 188 of Chapter X is without significance and that the powers of a debtor in possession in a Chapter XI case include the "rights" of a trustee. (p 961)
>
> The general purpose of Sec 342 is that where a debtor continues in possession of his property, he shall be in fact a trustee. (p 962)

II. CHEMICAL BANK ALLEGED LIEN VIOLATES LAW AND POLICY.

A. Appellee Chemical Bank's Alleged Lien Re Intangibles

As has been shown in Appellant's Brief of July 30, 1974, the Appellee Chemical Bank does not have a valid lien in any of the assets of the Appellant. But even if Appellee Chemical Bank had such a lien it would apply merely to the furniture of the Appellant. Nevertheless Chemical Bank still claims to have a lien in all sorts of things by virtue of the June 14, 1974 order of the Bankruptcy Court which granted to Chemical Bank a lien so broad as to be unimaginable and so vague as to be indefinable. Appellee Chemical Bank's brief sets out some of the rights allegedly belonging to it on pages 18 and 19 of its brief.

Paragraph 3 on page 19 sets out some of the things granted to Appellee Chemical Bank by the Bankruptcy Court in the June 14 Order. Sec. 9-105 of the UCC defines an Instrument as including:

> . . .any other writing which evidences a right to payment of money and is not itself a security agreement or lease. . .

Pursuant to Paragraphs 2 and 3 of the Order of June 14, 1974 quoted on page 19 of the Chemical Bank brief, many of the things listed would be defined as "instruments".

Section 9-304(1) of the UCC states:

> A security interest in instruments (other than instruments which constitute part of chattel paper) can be perfected only by the secured party's taking possession, except as provided in subsections (4) and (5).

Subsections (4) and (5) are not applicable to this case referring to a 21-day grace period in certain circumstances where possession need not take place for that period.

Since Appellee Chemical Bank has no possession of such instruments it could not have a lien on them and therefore the Referee's Order of June 14 is clearly in error.

B. Extent of Chemical Bank Lien.

The Appellant has argued that the Appellee Chemical Bank has been granted a lien so broad and vague and extensive as to be a violation of public policy. Chemical Bank does not really dispute this.

Even though a lien may be valid under state law or under federal non-bankruptcy law,

> Both are subject to being overridden by the bankruptcy law, including authoritative interpretations implementing the federal policy explicit and implicit in the Act.
> 4A Collier, p. 777.

There have been various holdings with regard to this provision in law that affect this case.

> In any event, whether asserting an equitable lien, assignment or other equitable interest, the claimant must identify and if necessary trace the property or funds so charged. Even those equities which are superior to the trustee under Sec. 70c, or similar provisions of the Act, cannot be said to be a charge against the whole estate to the detriment of other creditors.
> 4A Collier 696

Collier cites the case In re Pfau Mfg. Co., 294 Fed. 158 (CCA 6th, 1923). There the court cited ". . .the established rule that no equitable lien will attach to unidentified or unsegregated property of the bankrupt passing into possession and control of the trustee in bankruptcy, even where the contract apparently contemplates such a lien." (p. 161; emphasis supplied)

The rule is applicable to both the Chemical Bank and Chartered Bank liens. Therefore the decision hereinbelow is clearly in error. Chemical Bank has identified nothing. Chartered Bank has made a vain attempt at identifying something. Both Appellees have held from the inception of this case that they need not identify the goods or things to which their lien applies. They now claim such goods have been identified. What specific goods has Chemical Bank or even Chartered Bank identified?

In the Pfau case, although goods like those ordered and paid for by the complainant were in the stock of Pfau, they were not segregated and therefore the court would not impose a lien upon them. Since they were neither segregated nor traced, no lien attached. This is relevant to the case at bar. Even if somehow the Chemical Bank and even Chartered Bank alleged liens were valid under state law, they are invalid under the Bankruptcy Law. Appellant has previously noted that the Chemical Bank lien, if permitted, would vitiate the Bankruptcy statutes, since they would not permit a debtor to rehabilitate himself.

There is no statutory authority for the granting of a lien that would pursue the Appellant as a result of work commenced after entering Chapter XI proceedings. The work and services performed by the Appellant trustee for the benefit of the estate are not subject to any lien of the Appellees, and Chemical Bank's assertion to such a lien is in controvertion to all authority. Note that it offers no support for such a lien. Chemical Bank, Appellee, could only have a lien on property to which the prior debtor

had in its possession and had some immediate right to. Therefore, the Bankruptcy Court's Order of June 14, 1974 is clearly in error and not clear in its intent.

Furthermore, the granting of such a lien to Chemical Bank would be a preference over all other creditors and it is therefore void.

III. ENFORCEMENT IN EQUITY COURT OF ALLEGED LIENS.

Several questions arise as to whether in any event an equity court should enforce liens, even if valid under state law, where the parties asserting said alleged liens have not met the standards required for an equity court.

A. The Appellees Should Not Be Granted the Assistance of An Equity Court.

Chartered Bank has stated in its Brief before the District Court that the value of the inventory as assessed by its independent appraiser is $20,000. It has now arbitrarily raised that amount in its present brief. The value of the inventory to the Appellant at cost is in excess of $100,000 and at resale price may be as much as $200,000. Chemical Bank's alleged lien, if it applies to anything, applies merely to the furniture of the Appellant. The furniture can have little value to Chemical Bank but is essential for the Appellant.

Therefore, a court of equity should not take it upon itself to transfer goods from the Appellant to the Appellees where the value to the Appellant is great while the value to the Appellees is slight.

B. The Law Gives the Equity Court Discretion in This Area.

The courts heretofore have held that since equitable action is required, and in this case a turnover requires the act of an equity court and is not mere enforcement of a non-equitable legal right, then the equity court has substantial discretion.

For example, In Re Yale Express System, Inc., 384 F.2d 990 (CCA 2d, 1967) held that denial of reclamation was not an abuse of discretion where it appeared that prospects of reorganization would be frustrated by permitting reclamation.

Fruehauf was not only denied the right to reclaim its trucks and trailers in that case, but also denied rental on the trucks. This was held to be the case even though the Fruehauf trucks were depreciating.

In this case if the Order of June 14, 1974 is permitted to stand, presumably Chemical Bank would be entitled to the Appellant's furniture and possibly to its future earnings and Chartered Bank to its inventory or a part thereof. What greater frustration could there be of an attempted reorganization? The courts below did not give full consideration to this question, and it is respectfully submitted that the Order of June 14, 1974 of the Bankruptcy Court and the Opinions upon which it is based are in error.

C. Chemical Bank Lacks Clean Hands.

As has been discussed in Appellant's Brief of July 30, 1974, the Chemical Bank Agreement of April 23, 1974 and the Security Agreement signed thereunder were unconscionable, obtained by duress and in violation of Banking Laws.

In addition, the agreement may be uxorious. The Banking Law 14-a1, 2(a)(1) gives the Banking Board the right to prescribe rates of interest by the vote of 3/5ths of all its members. 4 McKinney's Consolidated

Laws of New York Annotated, 1973-1974 Suppl., p. 7. While there is exemption from the usury laws for demand loans that exceed $5,000 for banks, there is no exemption for other loans. See General Oblig. Law 5-101; 5-523 and Equitable Life Assoc. Soc. of U. S. v. Kerpel, 238 N.Y.S. 2d 1016 (1963).

If by collateral contract a benefit is secured for which the borrower receives no equivalent, and which the lender would not have obtained except for the loan, and it is intended as added compensation, then usury is involved.

A usury defense cannot be interposed by a corporation. (Gen. Oblig. Law 5-521) to invalidate the loan, but the Bank would be subject to penalties for violation of the law. Central Trust Co. v. Simmons Motor Corp., 215 N.Y.S. 2d 555 (1961).

Here where the Appellee Chemical Bank is looking to have an equitable right enforced in an equity court, then the court should clearly deny relief. The Chemical Bank agreements of April 23, 1974 were over-reaching, they violated banking law, they were obtained by duress and were uxorious in that the debtor had to give warrants to the Appellee Chemical Bank as part of the loan. Warrants have a distinct value in law and by Securities law.

As was stated in In Re Chicago Reed Co., 7 F.2d 885 (CCA 7, 1925) at p. 885:

> The later statute [re corporations not subject to usury laws] may or may not have repealed pro tanto the usury law of the state, but it did not abrogate the

> rule that courts of equity will not lend their aid to enforce contracts which upon their face are so manifestly harsh and oppressive as to shock the conscience.

The contract between the debtor and Appellee Chemical Bank could well fit the description found by the Court of Appeals, 7th Circuit in the above Reed case at p. 886, namely:

> This on its face we consider so glaringly and obviously harsh and oppressive that the bankruptcy court, wherein the principles of equity prevail, will not aid the petitioner to enforce it.

The Reed case was one where petitioner had lent $1,700 at 7% interest but took $2,000 in notes. The additional $300 was considered a commission. The court refused to allow enforcement of that, which the court noted would be usury if not for the corporate exemption. The case at bar is much more compelling since Chemical Bank took warrants, stock, guarantees, control of the working capital, financial reporting, salaries, and equity of the debtor, for antecedent debts that in fact remained demand loans. Now Chemical Bank wants an equitable remedy in an equity court and not merely money damages, and this should be denied.

1. Leading case on unconscionable contracts

See also the case of Hume v. U. S., 132 U.S. 406 (1889) where Chief Justice Fuller delivered the opinion of the court holding that where Hume had sold shucks to the Interior Department at 60 cents per lb., while the market price was 1-3/4 cents per lb., the petitioner could not prevail in suit for the full amount. The petitioner had argued that shucks

were only part of the contract and on the overall contract his profit, if any, was small. The court held at p. 411:

> "1. Then fraud, which is dolus malus, may be actual, arising from facts and circumstances of imposition; which is the plainest case. 2. It may be apparent from the intrinsic nature and subject of the bargain itself; such as no man in his senses and not under delusion would make on the one hand, and as no honest and fair man would accept on the other; which are unequitable and unconscientious bargains; and of such even the common law has taken notice; for which, if it would not look a little ludicrous, might be cited James v. Morgan, 1 Lev. 111."

The court described the type of contract that is unconscionable at p. 414:

> And there may be contracts so extortionate and unconscionable on their face as to raise the presumption of fraud in their inception, or at least to require but slight additional evidence to justify such presumption. In such cases the natural and irresistible inference of fraud is as efficacious to maintain the defence at law as to sustain an application for affirmative relief in equity.

It would seem that the overreaching agreement of Chemical Bank falls clearly into this area of being so extortionate and unconscionable as to sustain an application for denial of equitable relief. Here there is no question of the fact that Chemical Bank is seeking equitable relief.

See also 17 Corpus Juris Secundum at p. 846:

> Courts sometimes look to the adequacy of the consideration in order to determine whether the bargain provided for is grossly unreasonable or unconscionable in the light of the mores and business practices of the time and place as to be unenforceable according to its literal terms. Where the inadequacy is so gross as to shock the conscience and common sense of all men, it

> may amount both at law and in equity to proof of fraud, oppression, and undue influence. Where the inadequacy is such as to shock the moral sense, other circumstances, such as fraud, mistake, misapprehension, surprise, irregularity, or anything else which conduces to the inadequacy of price, will be readily seized on to void the agreement.

2. Ratification of Appellee Chemical Bank's contract

On page 21 of the Brief of Appellee Chemical Bank, an Agreement of December 13, 1973 is referred to which the Appellee implies amounted to ratification of its agreement of April 23, 1973. Since the Chemical Bank duress was continuing and has continued up until the time of the Chapter XI proceedings, that agreement of December 13, 1973 is not evidence of ratification. Secondly, an agreement which is unconscionable, and obtained by duress, and lacks consideration cannot be ratified. Thirdly, that agreement of December 13, 1973 as is explained in the uncontroverted testimony at the hearing of April 19, 1974 was obtained by coercion and duress.

The facts were the debtor needed a statement from Chemical Bank for its annual certified audit. Chemical Bank wrongfully refused such a statement and threatened to call all its loans unless the debtor signed the December 13, 1973 agreement. The agreement in any event makes no mention and does not refer to any other agreements such as the Security Agreement of April 23, 1973, which is the basis for the Chemical Bank claim.

3. Chemical Bank is listed as a Secured Creditor in Schedules.

Chemical Bank asserts on page 20 of its Brief that Chemical Bank was listed as a secured creditor in the schedules filed with the Bankruptcy Court petitioning protection of the Court. This is true.

Between the original debtor and Chemical Bank, there is no doubt that loans existed and the debtor knew that Chemical Bank attempted to secure those loans. As between the original debtor and Chemical Bank the loans may be valid, but the Appellant-Debtor-in-Possession, a trustee, is a new entity and the Appellant is in the status of a hypothetical lien creditor, and as such Chemical Bank cannot prevail against the Appellant. This failure to recognize the difference between the original debtor prior to entering Chapter XI and the Appellant is a serious weakness of the Chemical Bank case. Furthermore, as the Appellee Chemical Bank knows, as is elaborated in the original brief of the Appellant, the Appellant's attorneys questioned the validity of the alleged Chemical Bank security interest from the inception of the Chapter XI proceedings.

IV. APPELLEE CHARTERED BANK FINANCING STATEMENT

Appellee Chartered Bank asserts in its Brief on pages 11-16 that its financing statement was proper in all respects and cites numerous authorities to sustain its burden here. The facts and law require some comment.

A. The Lengthy Argument Before Judge Ward

Appellee Chartered Bank contends that not only were there hearings before the Bankruptcy Judge but "a lengthy argument" before Judge Ward in the District Court. While this may not be cogent, it is somewhat indicative of the argument presented. Because Chemical Bank and Chartered Bank handed their Briefs up at the time of the hearing and the Appellant only a short time before that, there was no real substantive hearing before Judge Ward much to his displeasure. The only substantive argument concerned the stay applied for by the Appellant.

B. New York Substantive Law is to be Applied

As the Appellant has noted herein while New York substantive law governs the validity of an alleged lien as the Appellee Chartered Bank asserts on page 12 of its Brief, it is subordinate to the Bankruptcy Law which is determinative on enforcement of an alleged lien.

C. Testimony Offered to Refute Presumption of Validity of Filing of Chartered Bank

Chartered Bank asserts that the only evidence offered to refute the presumption of proper filing was that of Miss Santangelo. This is clearly refuted by the testimony at the hearings. (See for example Appellants original Brief of July 30, 1974 pages 5, 6 & 7 and the relevant pages in the transcripts of the hearings referred to).

That Chartered Bank should assert on page 13 of its Brief that no evidence was offered to rebut a primia facie showing that they had filed their financing statement in New York County is to say the least, annoying. The Bank's Brief fails to mention the testimony of David C. Buxbaum and the search of Inter County and in fact on page 15 footnote 8 goes so far as to deny that the Inter County Clearance Company search is before the Court despite the fact that the order of Judge Galgay of June 14, 1974 drawn up by Chartered Bank and Chemical Bank makes reference to the affidavit of David C. Buxbaum which contains that search. Judge Galgay recognized this and the testimony of David C. Buxbaum made reference to other creditors who also found no filing.

D. Mistakes by the Clerk Re Chartered Banks Lack of Filing in New York County

Chartered Bank once again argues that the reason for the failure of the clerks at the New York County Registers office, Miss Santangelo, the Inter County Clearance Co. and a creditor of May Lee did not find the filing of Chartered Bank in the files of the New York County Register office, was because the clerk misfiled it.

Nowhere has the Appellee Chartered Bank offered one bit of evidence to sustain this allegation. When the Appellant came foward and proved that prior to entering Chapter XI proceedings no copy of the Chartered Bank filing could be found in New York County, if the Chartered Bank came foward and proved that it was missing as a result of a clerks error it may

have prevailed. Chartered Bank not only refused to come foward, it successfully and wrongfully kept out competent evidence. It cannot prevail in this case where it has not sustained its burden of proof. The cases it cites in its Brief are all unavailing since in each case, if they are even relevant, in that they were all decided prior to the UCC, they merely deal with a situation where a clerk made an error. (See pp 14 & 15 of Chartered Bank's Brief). There is no showing in this case that a clerk made an error. The UCC is a notice statute. There was no notice! An ideal hypothetical lien creditor, the Appellant therefore, it is respectfully submitted, must prevail.

Chartered Bank cites Mutual Board & Packaging Co. v. Oneida National Bank & Trust Co. 342 F 2d 295 (C C A 2d 1965) on p 14 of its Brief to support it. The facts in the Oneida case had to do with the claim of ExCello that it had fowarded its conditional sales contract and fee to the county clerk which returned the enclosures improperly demanding a notorial certificate. The Uniform Commercial Code was not at issue here in the Oneida case. Therefore its relevance is in doubt. Furthermore the court on p 297 specifically states that:

> "two New York cases are cited as holding that delays in receipt or filing by the clerk are matters for which the person seeking to file is responsible."

The court discounts the applicability of the two cases to the Oneida case which it says is more like another case where the clerk improperly refused

to file an assignment (p 297).

The court held that:

> If one balances interests between a creditor who does his best to file and is prevented by the clerk from doing so, and another who does his best to research and is prevented by the clerk from finding what he is looking for, the loss may well be held to fall on the second creditor rather than the first because of the first creditors' prior effort. (pp 297, 298)

The case here is not at all similar since it is between an ideal hypothetical lien creditor and the Appellee. It is more like the two cases cited by the court. The Oneida case was remanded to determine what the facts were since there were no findings as to what happened. The case does not seem to support the Appellee Chartered Bank.

Empire State Chair Co. v. Beldock 140 F 2d 587, (CCA 2d 1944), cert. den. 322 U.S. 760 is cited on p 14 of Appellee Chartered Bank's Brief. Said case also preceeded the UCC and its relevance is also limited.

The case seems in any event to support the Appellant since it holds, offering other cases on p 588

> ...that the recording of a conditional sales contract for machinery and equipment described in an annexed schedule (Exhibit A) was not valid against the vendees trustee in bankruptcy where Exhibit A was not filed.

The court further stated on p 589

> [1] We see no reason to conclude that the filing of a contract with a part omitted--and in some respects the most important part from the standpoint of notice--should be considered an adequate filing under Personal Property Law, sec. 65.

> [2] The contention is also advanced that the bankruptcy trustee cannot take advantage of improper filing under sec. 65; but the contrary is too well settled to require discussion of the point.

What could more clearly sustain the Appellants position that where there were no attachments to the Security Agreement of Chartered Bank, though some and only some referred to attachments, they were invalid.

Mutual Life Ins Co v. J.W. Drake 87 N.Y. 257 (1881) cited by Appellee on p 14 of his Brief deals with the indexing of a mortgage and is not at all relevant to the UCC.

In Re Labb 42 F. Supp. 542 (W.D. N.Y. 1941) cited on p 15 of the Appellee Chartered Bank's Brief deals with the filing of conditional sales contracts. There the filing officer made a clear mistake, something Chartered Bank, having the burden of proof, has failed to show in this case.

The best case cited by the Appellees to sustain their position is In Re Royal Electrotype Corporation, 485 F. 2d 394 (3rd Circ., 1973). In that case the court applied Pennsylvania law and considered the case one of first impression. There the court held that where the filing officer made a mistake, and there was clear evidence that he did in that case, then the party who attempted to perfect his filing is secured. In this case at bar Chartered Bank has shown nothing to indicate that a filing officer made a mistake. The cases in New York seem to lean the other way. While there is no holding on point in New York this Court would have to go beyond the 3rd Circuit and hold not only that where the filing officer made a mistake,

was a potentially secured party protected, but also where no mistake was made, but no filing was present a potentially secured party was protected against an ideal hypothetical lien creditor. Such a holding would be unique and it would seem, help to weaken the very basis of Article 9 of the UCC which is a notice statute. New York law is also slightly different than Pennsylvania law.

V. ISSUES IN APPELLEES BRIEF

A. Chemical Banks Statement of Facts

On pages 12, 13 & 14 of the Appellee Chemical Bank's Brief a colloquy is quoted referring to a hearing at an adjourned first meeting of creditors. The Brief does not indicate, however, that subsequent to this meeting, a rehearing was held and a new opinion rendered by Judge Galgay. The hearing referred to and the original opinion referred to were all prior to the hearing on Chemical Banks alleged lien - since during the first hearing there was no substantive contest regarding the Chemical Bank alleged lien.

B. Chemical Banks Interest in the Assets of May Lee

On page 20 of its Brief Chemical Bank boldly asserts:

> Thus CHEMICAL has a valid security interest in all assets of May Lee.

No modesty here; the past, future, present, and all assets, Chemical asserts, of May Lee, belong to Chemical Bank. No need to identify any assets, says Chemical Bank, since they all belong to Chemical. Presumably the employees of the debtor would be indentured servants of Chemical Bank, perhaps forever, or merely for life.

C. The Security Agreements Referred to Attached Invoices

On page 31 of its Brief Chemical Bank states that "...the security agreements did give actual general descriptions of the goods and referred to attached invoices which the Court found were specific in describing the collateral...." This is a fair description of Judge Galgay's

position on the Chartered Bank trust receipts.

It contains numerous errors of the most elemental and clear kind.

1. The Chartered Bank Security Agreements give a General Description

(a) All the descriptions on the trust receipts are listed on page 47 of the original Brief of the Appellant of July 30, 1974. Some have no description and are in blank. This is a clear error by Judge Galgay. Some have a description - "general merchandise" this is not even a general description.

2. The Chartered Bank Security Agreements Referred to Attached Invoices

The Chartered Bank Security Agreements do not all refer to attached invoices. Some do and some do not. This is another clear error of the Bankruptcy Court.

3. The Attached Invoices are Specific

The attached invoices are not specific. Some say general merchandise, some say 1 pkg silver jewelry. This is not specific. Thus we find another clear error on the part of the Judge in the Bankruptcy Court.

4. The Attachments are Invoices

The attachments to the trust receipts are not all invoices. Some are customs forms. Another clear mistake was made by the Court below.

5. The Attachments were Attached

The Bankruptcy Court never determined whether or not the invoices or customs forms were actually attached to the trust receipts. The uncontradicted evidence was that they were not attached. The Chartered Bank has, in cases cited in its own Brief, shown that these invoices or documents would have to be attached to have a valid security agreement. They were not attached - therefore another clear error was made by the Courts below.

6. The Evidence of Chartered Bank was Trust Receipts

The Court below did not examine the documents submitted by Chartered Bank with care. At least three documents are mere invoices without trust receipts. These of course, cannot be security agreements and thus the Court below made another clear error.

7. The Documents Submitted in the Reclamation Petition of Chartered Bank were the same as those Submitted into Evidence.

The Opinion and Order of Judge Galgay presumes that the documents submitted into evidence are identical to those that were part of the petition. In fact the documents differ and the attachments differ to some of the same documents. What could be a clearer case of error, and support the position that the attachments were arbitrary.

8. There is Some Relationship Between the Attached Documents and the Trust Receipts

The holding of the Court below presumes some relationship

between those trust receipts and the attachments. In most cases there is no such relationship. The amounts, quantities, etc. all differ.

D. The Chemical Bank Alleged Lien Covers the Collateral Covered by the Chartered Bank Lien

Chemical Bank on pages 37-39 of its Brief fails to deal with the question of whether as between Chemical and the Appellant, a new entity and a trustee, its lien is good. It still retains the argument that the restriction on its lien is not meaningful since whatever Chartered Bank does not get Chemical Bank will receive. It asserts on page 39 of its Brief that the restriction "...clause was drafted by May Lee.", offering no evidence of this assertion heretofore nor not suggesting its relevance. It further asserts on page 39 that "...May Lee has no feasible prospect of operating at a profit in the future." It also offers no evidence of this fact and the evidence in fact is to the contrary.

Therefore presumably Chemical Bank should receive an undefined lien on all the assets of the Appellant except those that go to Chartered Bank. Certainly this is a most brazen and unique legal assertion. All assets to Chemical whether defined, described, subject to description or limitation, and irrespective of specific limits in their own agreement with the debtor and despite the fact that the Appellant is a trustee and is to be treated as a hypothetical lien creditor. This is probably the most unique assertion in the history of Bankruptcy and the fact that the Order of June 14, 1974 of the Bankruptcy Court seems in part to sustain the unbelievable position of Chemical Bank, irrespective of law or fact, makes the Bankruptcy

Judge's Order the clearest case of error one could imagine.

E. The Chartered Bank Introduction of Evidence

1. Admission of Documents

The Chartered Bank Brief, like the Chemical Bank Brief, refers on pages 7-9 to the hearing of April 9, 1974 as if it were the only hearing. They do not discuss the fact that on April 19 there was a further hearing and that objections were made to their evidence. For example question was raised whether the $2.00 fee was properly paid and identified at the April 19 hearing. In addition the Chartered Bank testimony was merely for purposes of identification and not an offer of evidence. See page 58 lines 22 and 59 of the hearing of April 9, 1974 where the Judge states:

> I will allow you a very limited examination with respect to the documents you have in your hand. But as I envision this, I am going to allow these documents to be marked for identification. You are going to be given an opportunity to study these documents. At the next hearing, unless there is some problem, I am just going to admit the entire folder.

2. Evidence Introduced Regarding Filing

Chartered Bank infers on page 8 of its Brief that the only evidence regarding its lack of filing of a Financing Statement in New York County was that of Laura Santangelo. The fact that a creditor of May Lee, the clerks in the New York County Registers office, Inter-County Clearance Company, and Laura Santangelo and Chemical Bank all could not at different times find the alleged financing statement of Chartered Bank in New York County is ignored by the Chartered Bank. See pages 5-8 of the Appellants Brief of July 30, 1974 and the transcripts of the hearings of April 19, 1974

pages 57, 58-61, June 7, 1974 pages 18 & 19, etc.

3. Testimony of Laura Santangelo

The Chartered Bank Brief on pages 15 & 16, like that of Chemical Bank, states that Judge Galgay discounted or placed no credence on Miss Santangelo's testimony. Since there is absolutely no evidence of this assertion and since neither Chartered nor Chemical Bank introduced evidence contrary to the assertions that no Chartered Bank filing could be found in the New York County Registers office prior to the Chapter XI proceedings, it would seem that this assertion is totally without merit. Chartered Bank and Chemical Bank did not even challenge the testimony of Miss Santangelo nor raise questions as to her credibility. They never contradicted any of the evidence about a lack of filing in the files of New York County and never introduced evidence that some clerk had made a mistake. Thus between the Appellant and Chartered Bank, the Appellant, an ideal hypothetical lien creditor must prevail. The burden of proof was upon Chartered Bank. It came foward with some primia facie evidence of a filing but did not sustain its burden by failing to come foward with evidence when it was shown that no filing was or could be found in the files.

F. Omissions in the Briefs of Appellees

It should be noted that many of the legal arguments of the Appellant in its Brief of July 30, 1974 are unchallenged by the Appellees. For example, the Appellees do not challenge the assertion that the Appellant is to be treated as an ideal hypothetical lien creditor and a trustee, that

Chartered Bank and Chemical Bank must prove their interests in the Appellants property, that the Chemical Bank lien is invalid as a matter of public policy, that the entire Reclamation Proceedings were brought in violation of law, that the Chemical Bank agreements are illegal under the banking laws and lack consideration and that there were numerous mistakes in the Opinion below regarding trust receipts. (Chartered Bank claims the Appellant has selected a few trust receipts out of context). This failure to meet the legal arguments of the Appellant should be regarded as admissions and therefore it is respectfully suggested the Appellant should prevail. Note also that Chartered Bank does not deny it is not entitled to the proceeds of sales of any collateral. It also offers no concrete evidence to dispute the uncontradicted evidence at the hearings that it was only one of the Banks that financed the debtors inventory.

CONCLUSION

Wherefore, it is respectfully prayed by the Appellant, that the Order of June 14, 1974 be set aside, and that the Decision and Order of the District Court and Bankruptcy Court be set aside and that Chartered Bank and Chemical Bank be held unsecured parties and that the stay order be dissolved forthwith.

Respectfully Submitted,

DATED: New York, New York

August 8, 1974

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UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

In the Matter -of- MAY LEE INDUSTRIES, INC., Appellant.	Docket No. 74-1982
	AFFIDAVIT OF SERVICE

STATE OF NEW YORK)
) ss.:
COUNTY OF NEW YORK)

LAURA SANTANGELO, being first duly sworn, deposes and says:

That deponent is not a party to the action, is over 18 years of age and resides at 415 Stratford Road, Brooklyn, New York.

That on the 8th day of August 1974 at Nos. 230 Park Avenue New York, New York and 67 Wall Street, New York, New York, deponent served the within Reply Brief for Appellant, Trustee on Appeal from Order of District Court dated August 8, 1974 on parties therein named, by delivering a true copy of each to said parties via their attorneys OTTERBOURG, STEINDLER, HOUSTON & ROSEN, P.C., attorney for Chemical Bank and HAWKINS, DELAFIELD & WOOD, attorney for Chartered Bank, personally; deponent knew the persons so served to be the attorneys for the parties described therein.

Laura Santangelo
LAURA SANTANGELO

Sworn to before me this
8 day of August 1974

DAVID C. BUX[illegible]
Notary Public, State of New York
No. 24-0524590
Qualified in Kings County
Certificate filed in New York County
Commission Expires March 30, 1975